In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1480

GLENN W. TURNER ENTERPRISES, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

Petitioners Glenn W. Turner Enterprises, Inc., and its subsidiary Dare To Be Great, Inc., as well as a number of individuals associated with the two corporate entities, challenge a preliminary injunction enjoining petitioners from offering and selling certain of their "Adventures" and "Plans," the nature of which are detailed in the opinions of the courts below (Pet. App. 2-4, 16-18), and from withdrawing

certain funds from the assets of Dare To Be Great, Inc.

1. Petitioners purport to offer a series of self-improvement courses, described as "Adventures" and "Plans," to members of the public at prices of up to $5,000. The overwhelming emphasis of petitioners promotion, however, is upon the profits that will be obtained if the participant recruits other persons to take the same course. These new recruits in turn obtain a similar opportunity to profit from the recruitment of still others in an apparently never-ending chain (Pet. App. 2, 4, 18). As the district court observed, a "pyramid" scheme of this type is "inherently unstable and eventually must collapse" (Pet. App. 22). The success of the venture "is based upon blinding potential prospects to the realities of the scheme" (Pet. App. 24). The scheme depends for success upon high-pressure, deceptive sales tactics orchestrated by the defendants. At its heart are emotionally charged gatherings of investors and prospective investors, conducted like revival meetings by the defendants' agents, at which extravagant claims of potential income predominate. Large sums of money, expensive cars and flashy attire are displayed for the benefit of new prospects in order to create the appearance of near inevitable financial success of all who have joined and will join the venture. (Pet. App. 4-6, 19-21.) The court of appeals, after reviewing the record, affirmed the finding of the district court that petitioners' schemes, which have ensnared many thousands of investors, are "a gigantic and successful fraud" (Pet. App. 2).

The court of appeals likewise agreed with the district court that petitioners are selling "securities" within the meaning of the Securities and Exchange Act. The district court had concluded that the interests petitioners sell are within each of the following three terms used in the definition of security in 15 U.S.C. 77b(1) and 78c(a)(10): (1) an "investment contract," (2) a "certificate of interest or participation in any profit-sharing agreement," and (3) "any interest or instrument commonly known as a 'security'" (Pet. App. 26-34). The court of appeals held that the interests sold are clearly securities because they are "investment contracts." It therefore found it unnecessary to determine whether the schemes fit within the other two categories (Pet. App. 8). Accordingly, the court of appeals affirmed the preliminary injunction.

2. Petitioners argue that the holding of the court of appeals is inconsistent with *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293, where the Court defined an "investment contract" as a scheme involving "an investment of money in a common enterprise with profits to come solely from the efforts of others" (328 U.S. at 301). Since some participation in the schemes here at issue was required of the investor, petitioners claim that the schemes were not investment contracts.

The court of appeals properly rejected this claim, stating in part (Pet. App. 11-12):

> We hold, however, that in light of the remedial nature of the legislation, the statutory pol-

> icy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities. * * *
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> * * * Adherence to * * * an interpretation [urged by petitioners] could result in a mechanical, unduly restrictive view of what is and what is not an investment contract. It would be easy to evade by adding a requirement that the buyer contribute a modicum of effort. Thus the fact that the investors here were required to exert some efforts if a return were to be achieved should not automatically preclude a finding that the Plan or Adventure is an investment contract. To do so would not serve the purpose of the legislation. Rather we adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise. [Footnote omitted.]

Applying this "realistic test" here, the court of appeals concluded (Pet. App. 12):

> In this case, Dare's source of income is from selling the Adventures and the Plan. The purchaser is sold the idea that he will get a fixed part of the proceeds of the sales. In essence, to get that share, he invests three things: his money, his efforts to find prospects and bring

> them to the meetings, and whatever it costs him to creat an illusion of his own affluence. He invests them in Dare's get-rich-quick scheme. What he buys is a share in the proceeds of the selling efforts of Dare. Those efforts are the sine qua non of the scheme; those efforts are what keep it going; those efforts are what produce the money which is to make him rich. In essence, it is the right to share in the proceeds of those efforts that he buys. In our view, the scheme is no less an investment contract merely because he contributes some effort as well as money to get into it.

The holding of the court of appeals is consistent with this Court's admonition that the term "security" embodies a flexible rather than a static principle, * * * capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," and that "in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality". *United States* v. *W. J. Howey Co.*, 328 U.S. 293, 298, 299;[1] *Tcherepnin* v. *Knight*, 389 U.S. 332, 336; *Securities and Exchange Commission* v. *Joiner Corp.*, 320 U.S. 344, 351.

Contrary to petitioners' claim, the decision below is not in conflict with that of any other court of ap-

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[1] The Court in *Howey* cited with approval a state court decison, (*State* v. *Gopher Tire & Rubber Co.*, 146 Minn. 52, 177 N.W. 937), in which an investment contract was held to exist although investors were required to join promotional efforts.

peals. The cases cited by petitioner do not involve the application of the term "investment contract" to a pyramid promotion scheme, nor do they deal with the issue whether the performance by investors of some duties unrelated to the essential management efforts of an enterprise would preclude application of this Court's definition of an "investment contract." [2]

3. In any event, the district court correctly determined that the petitioners are selling interests "commonly known as a 'security'" and "certificate[s] of interest or participation in * * * [a] profit-sharing agreement," so that the judgment of the court below that the defendants have offered and sold securities

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[2] The court of appeals decisions cited by petitioner are also factually inapposite. In all but one of them the transaction involved was held to be a "security." The exception is *Graham* v. *Clark*, 332 F. 2d 155 (C.A. 6), in which oil and gas leases, with the reservation of an oil payment in the seller as deferred consideration, were held not to be within the statutory definition of security as including any "fractional undivided interest in oil, gas or other mineral rights." In the only case cited bearing a resemblance to the instant factual setting, *United States* v. *Herr*, 338 F. 2d 607 (C.A. 7), an "inactive distributorship" in which the investor's only contribution was the supply of capital, was held to be an "investment contract." The opinion in that case contains some suggestion, consistent with the opinion below, that performance of some efforts by the investor would not have altered the result. Although a district court has held a similar pyramid promotional scheme (also affiliated with Glenn W. Turner Enterprises, Inc.) to be beyond the scope of the statutory definition of "security" (*Securities and Exchange Commission* v. *Koscot Interplanetary, Inc.*, (N.D. Ga., No. 17134, April 19, 1973), an appeal in the Court of Appeals for the Fifth Circuit from that decision is pending.

is correct, even if the interests sold should not be considered investment contracts.

a. In holding that the interests petitioners sold are "commonly known as a 'security,'" the district court did not, as petitioners suggest (Pet. 9-10, rely "solely on the basis that some state courts had found the Petitioners' or similar contracts to be securities under the state securities laws." It based its decision on the rationale that (Pet. App. 27):

> [t]he subjection of the investor's money to the risk of an enterprise over which he exercises no managerial control is the basic economic reality of a security transaction.

This Court's decisions applying the term "security" to various transactions shows that this is the governing principle. See *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, where the Court specifically stated that the proof "seems clear that . . . [t]he defendants' efforts . . . were within the term 'any interest or instrument commonly known as a security,'" 320 U.S. at 351. There the cost of drilling a test oil well was financed by sale of leaseholds on adjacent acreage to members of the investing public who had no control over the well-drilling enterprise. *Id.* at 346. See, also, *Securities and Exchange Commission* v. *W. J. Howey Co.*, *supra*, 328 U.S. at 300, where this Court noted: "The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise"; *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Co.*,

359 U.S. 65, 71, which involved an annuity that "place[d] all the investment risks on the annuitant, none on the [insurance] company" which managed all of the annuitants' investments and determined investment policy. Similarly, the "Flexible Fund" program discussed in *Securities and Exchange Commission* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 211, was "pitched to the same consumer interest in growth through professionally managed investment" as mutual funds. And in *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 338, the petitioners were found to be "participants in a common enterprise—a money-lending operation dependent for its success upon the skill and efforts of the management of * * * [a Savings and Loan Association] in making sound loans."

b. The district court also properly concluded that the "plain meaning" of the phrase "certificates of interest or participation in * * * [a] profit-sharing agreement"—another of the descriptive terms contained in the statutory definition of "security"—encompasses the transactions involved in this case. As it explained: "What the investors receive, after all, is a right to a [share] of the profits from other investors" (Pet. App. 34). The petitioners' basic response (Pet. 10) that only "commissions" are involved merely describes the form in which the petitioners have chosen to cast their agreements with investors. This Court has made clear that, in determining whether a security is involved, the concept of profit may be something other than that used in a narrow account-

ing sense. Thus, while *Howey, supra,* 328 U.S. at 299, held that the promise of "profits" is an element of an "investment contract," this Court has also determined that an investment contract exists where the profits would result from market price appreciation. See *Joiner, supra*; *Variable Annuity Life Insurance Co., supra*; and *United Benefit Life Insurance Co., supra.*

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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